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BBVA Research Flash

Brazil

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Economic Analysis

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Brazil: until when will the current account deficit remain stable?

The current account deficit was equal to 2.1% of GDP in August, within the 2.1%-2.3% range it has been since the middle of 2010. The expansion of the deficits in both income and services accounts have been offset by a strong trade balance (thanks to high terms of trade). We expect this deficit to move out of the recent range next year: in our base scenario it should reach 2.9% of GDP by the end of 2012

- **The current account deficit was equal to USD 4.2 billion in August, more than markets expected (USD 3.0 billion) and in line with the USD 4.1 billion average deficit observed in the year up to now.** The current account deficit accumulates now USD 49.7 billion in the last 12 months, which represents 2.1% of GDP (2.1% in July as well). We expect it to remain within the recent range till the end of the year.

- **In August exports grew 36%y/y (18%m/m) and imports 32%y/y (17%m/m). Therefore, the trade balance continued improving and preventing the current account from deteriorating.** The trade surplus accumulated between January and August is now equal to USD 20.0 billion, 72% higher than in the same period last year.

- **Both services and income accounts continued displaying significantly high deficits (1.6% and 1.9% of GDP, respectively, in the last 12 months)** driven by an appreciated exchange rate and robust domestic demand.

- **There was in August more than enough external funding available: the capital and financial account amounted to USD 10.1 billion** (more than the double of the current account deficit in the period).

- **FDI were again very strong: they reached USD 5.6 billion in August (markets expected around USD 4.2 billion), and USD 75.4 billion (3.2% of GDP) in the last 12 months.** On the other hand, net portfolio investments reached only 0.5 billion this month (USD 3.2 billion on average in the Jan-Jul period).

- **Looking forward, external accounts performance will clearly depend on the development of the crisis in developed markets.** Stress situations will affect some of the main drivers of the external accounts such as the exchange rate and funding conditions.

- **Last days' turbulences are illustrative: the real depreciated sharply (around 17% since the beginning of the month)** and the CB was then forced to abandon daily USD purchases and to offer currency swaps contracts amounting to USD 2.7 billion to provide liquidity in dollars, which ended up calming markets down.

- **As the global scenario is expected to remain stressed in the next months, more supply of liquidity in dollars should not be seen with surprise (the CB has currently more than USD 352 billion in international reserves)** and a step back in the implementation of the IOF tax in FX derivatives markets should not be ruled out. Moreover, two additional 50 bps SELIC cuts should be expected this year.

- **In this uncertain environment, our base scenario incorporates a moderation (but not a recession) of developed economies, a slightly more depreciated currency** (1.7 on average in 2012), resilient commodity prices, and a weaker but still strong domestic demand. In this scenario the current account deficit would start deteriorating more sharply in the beginning of 2012 and would reach 2.9% by the end of the year. In this scenario, FDI would continue funding most of the current account deficit.
- **In a risk scenario where developed economies face a new recession, the current account should initially deteriorate** (following a sudden deterioration of terms of trade and higher global risk aversion) and then ease significantly in line with an adjustment of both exchange rate and domestic demand. FDI would weaken and international reserves would then be used to provide liquidity in dollars.
- **In any scenario, therefore, the current account deficit is expected** to move away from the 2.1%-2.3% range.

For more on Brazil, click here

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